



Business and Income Taxes Division – Compliance Fiscal Year End 2014 Report

Compiled by Jill Hamilton, Management Analyst

Table of Contents

Introduction

Overview of Business and Income Taxes Division	3
--	---

Compliance

Compliance Results	4
Audit Collection Comparison by Fiscal Year	5
Office and Field Audit Collections Breakout	6

Income and Withholding

Individual Income Tax	7
Pass-Through Entities	8

Business Tax and Valuation

Corporate Income Tax.....	9
Miscellaneous Tax.....	10
Natural Resources Tax.....	11
Industrial and Centrally Assessed Property	12-13

Administrative Research Team

Summary of Responsibilities	14
-----------------------------------	----

All Division Work

Work Items Completed.....	15
GenTax Discovery.....	16
Statement of Account/Tax Appeals.....	17
Fraud Prevention.....	18

Introduction

The Business and Income Taxes Division (BITD) oversees audits and verifies compliance with Montana laws for all state taxes administered by the department, specific programs assigned to the department, and appraisals and assessments of industrial and centrally assessed property.

The purpose of this report is to provide summary information on the main performance measures currently tracked by the BITD. The performance measures give a glimpse of the amount of work and accomplishments achieved by the division. To be successful in meeting our mission, all of the division resources must be focused on the common goals of ensuring compliance and administering tax laws fairly. The outstanding effort demonstrated by the division employees has allowed our division to produce impressive results and meet our fiscal goals.

BITD consists of two bureaus: Business Tax and Valuation (BTV) and Income and Withholding Taxes (IWT) with the support of one administrative unit.

Throughout the report several common performance measures are used. These common measures are defined as follows:

Audits: Audit activities determine the correct tax liability for individuals and business entities in accordance with the Montana laws. These activities include the detailed examination of tax returns and supporting documents.

Work Items: A work item is a task that is tracked by Gentax and must be completed. Work items can be assigned to specific users, or put in a work item queue by the system. Users may search and work them accordingly. Work items can be manually created or automatically generated through Gentax during return (batch) processing for the majority of all tax types in the system.

Leads (Discovery): A lead is identified through scoring models and filter criteria in the Discovery manager. Leads can be created and assigned to certain auditors to review and make adjustments as necessary to Montana tax filings. From a lead, an auditor may send letters, make notes, adjust returns, or perform desk or field audits.

Appraisals: Appraisals are conducted periodically to ensure that market value is achieved in accordance with Montana laws.

Compliance Results

Summary of Compliance Activities Fiscal Year End 2014 July 1, 2013 – June 30, 2014

Compliance Activities	First Half	Second Half	Total
Individual Income Tax	\$ 19,031,900	\$ 23,083,480	\$ 42,115,380
Corporate Income Tax	\$ 4,475,700	\$ 6,289,770	\$ 10,765,470
Natural Resource Tax	\$ 2,041,500	\$ 481,500	\$ 2,523,000
Miscellaneous Taxes	\$ 1,921,900	\$ 1,098,800	\$ 3,020,700
Pass-Through Business Taxes ²	\$ 605,200	\$ 1,246,640	\$ 1,851,840
Centrally Assessed/Industrial Property ³	\$ 0	\$ 201,525	\$ 201,525
Total Audit Collections	\$28,076,200¹	\$32,401,715¹	\$60,477,915¹

Summary of Compliance Activities Fiscal Year End 2013 July 1, 2012 – June 30, 2013

Compliance Activities	First Half	Second Half	Total
Individual Income Tax	\$ 16,624,385	\$ 16,808,300	\$ 33,432,685
Corporate Income Tax	\$ 10,878,470	\$ 5,942,770	\$ 16,821,240
Natural Resource Tax	\$ 5,260,690	\$ 1,045,805	\$ 6,306,495
Miscellaneous Taxes	\$ 2,001,620	\$ 1,403,955	\$ 3,405,575
Pass-Through Business Taxes ²	\$ 360,320	\$ 511,430	\$ 871,750
Centrally Assessed/Industrial Property ³	\$ 0	\$ 378,400	\$ 378,400
Total Audit Collections	\$35,125,485¹	\$26,090,660¹	\$61,216,145¹

¹GenTax Discovery collections are included in the Audit Collection total.

²All individual collections attributed to pass-through compliance activities are included in the Individual Income Tax total.

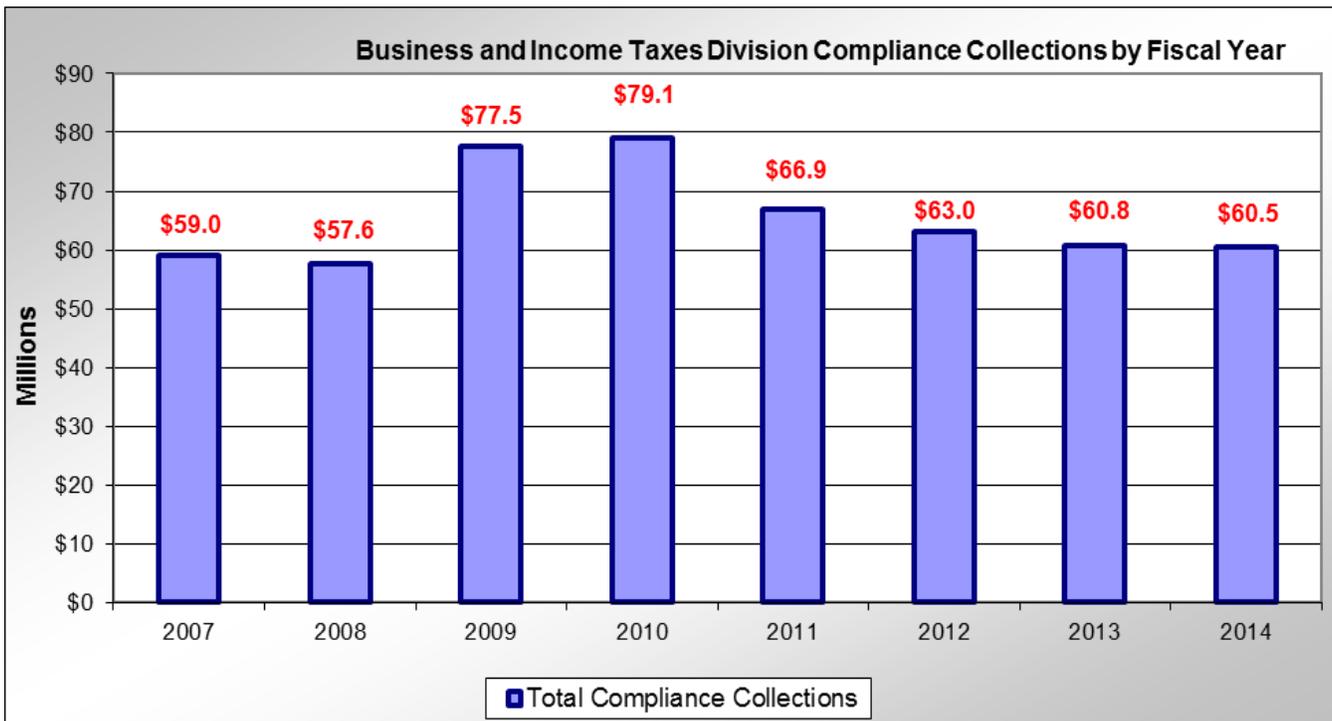
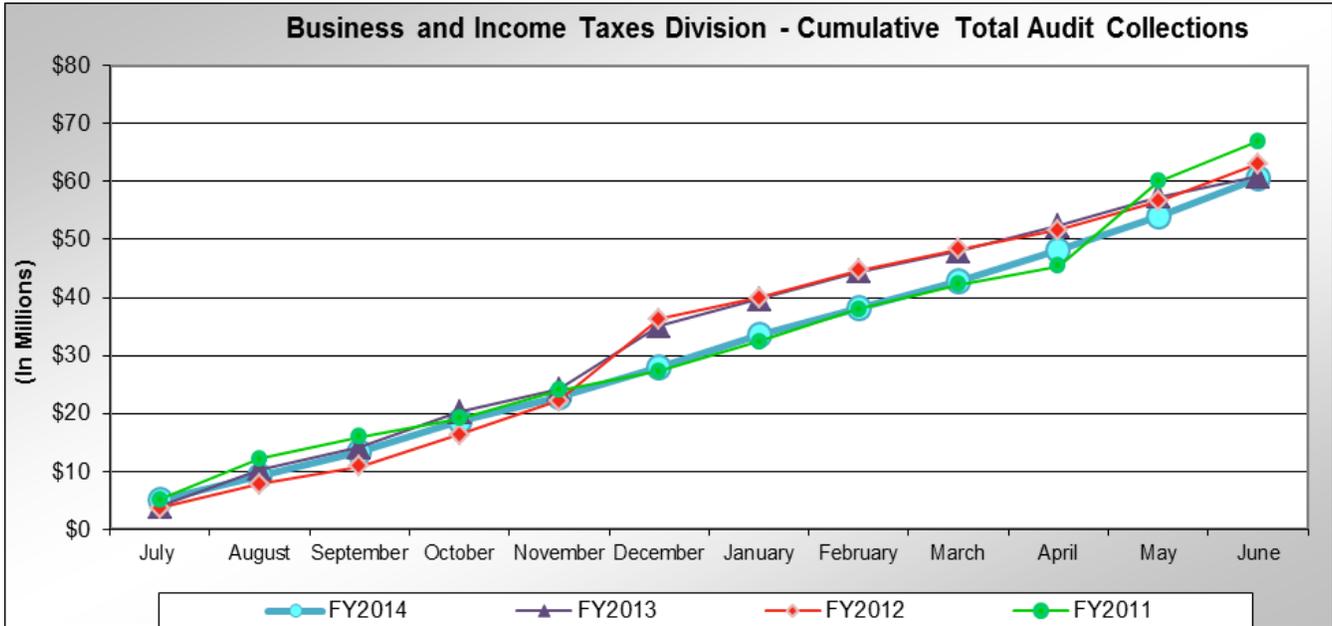
Further note: Activities associated with delinquent account receivables of taxes owed are also included in the Audit Collection total.

³Audit collections are a reflection of the audit work done, however collections may be paid to the State or County.

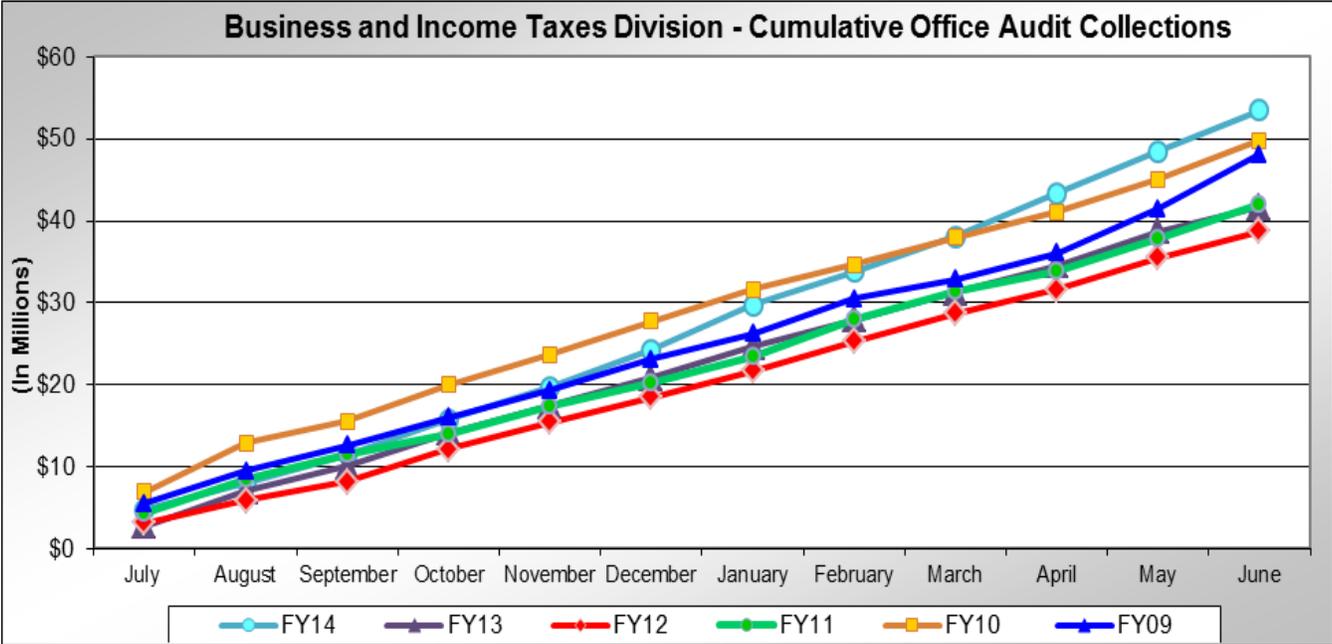
Audit Collection Comparison by Fiscal Year

The following line chart compares FY14 audit activities with those of the three prior fiscal years. Detailed information of audit collections by tax type for FY14 is shown in the following pages.

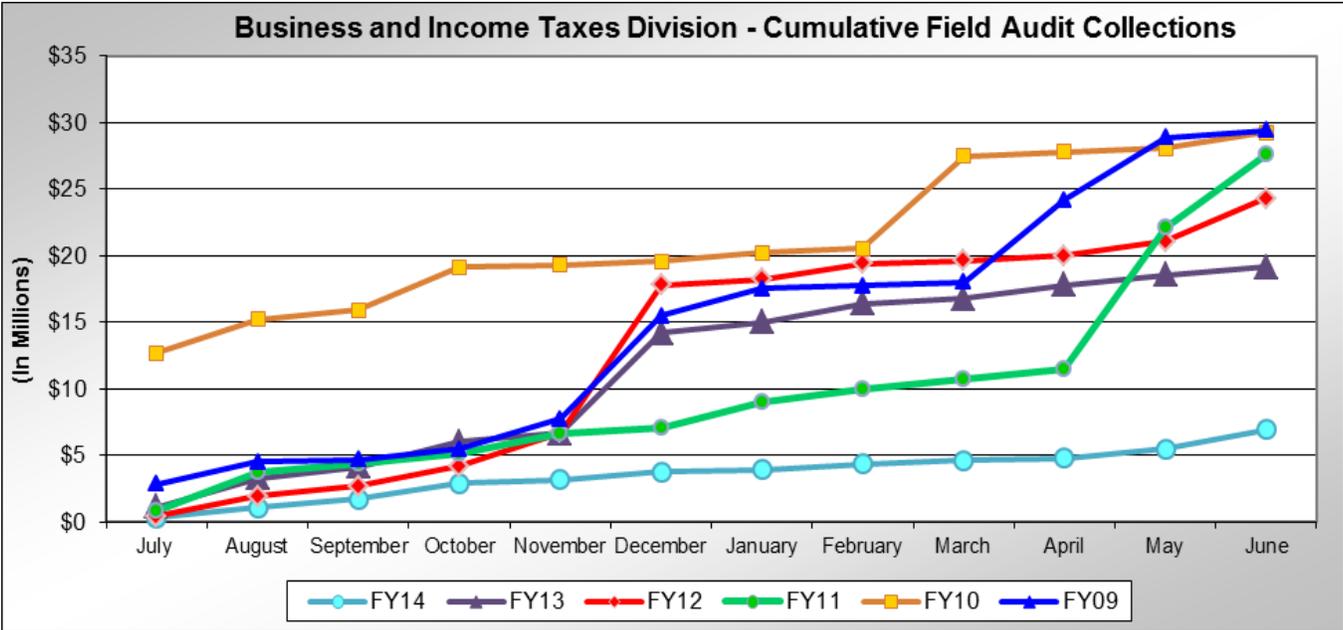
Total Audit Collections: \$60.5 million



Office Audit Collections: \$53.5 million



Field Audit Collections: \$7.0 million

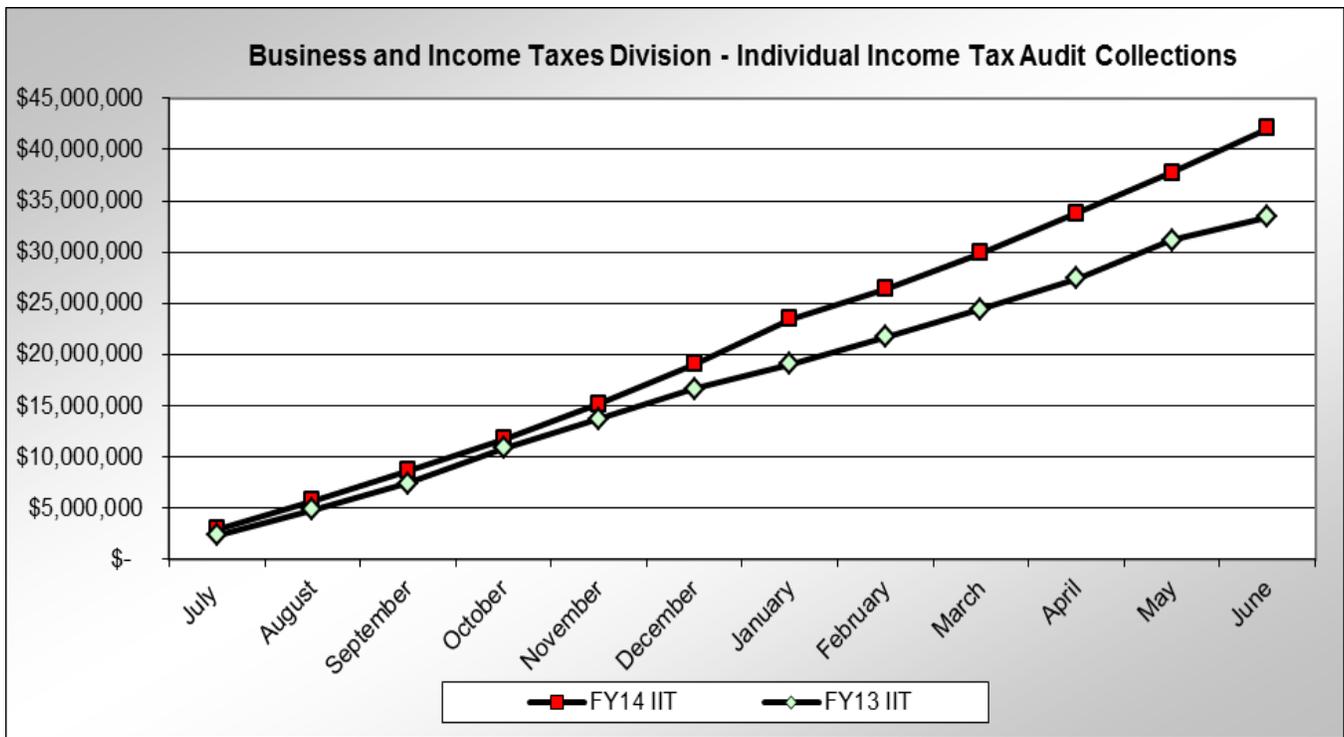


Individual Income and Withholding Taxes

In Montana, the individual income tax has a graduated rate structure with rates ranging from 1% to 6.9% of taxable income. This is a “progressive” tax because taxpayers with higher incomes pay a higher percentage of their income. Not only are residents of Montana required to file, but part-year residents and non-residents with income from Montana sources are required to file an individual income tax return.

Income tax revenues are collected primarily through employer withholding, periodic estimated tax payments, and payments made when the return is filed. In addition, audit collections are included in the overall income tax revenue and are collected through audit and bill payments.

Individual income tax audit collections for fiscal year 2014 totaled \$42.1 million.

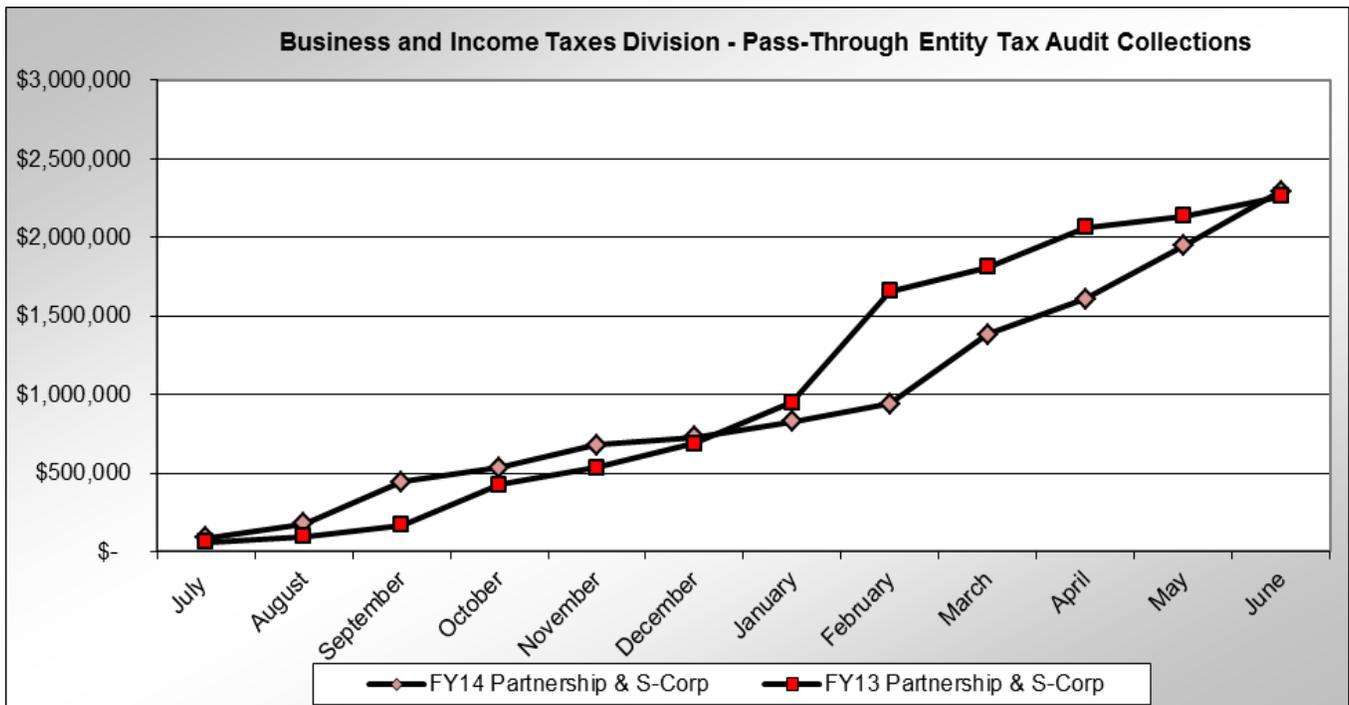


Pass-Through Entities

Increasingly, in Montana and nationwide, business and investment activities are being conducted by pass-through entities. The most common type of pass-through entity today is the limited liability company or LLC. Other types of pass-through entities are partnerships, S corporations, fiduciaries, and disregarded entities. Income and expenses are reported in the tax returns of the owners. These owners can be corporations, individuals, other pass-through entities, or a mix of all of them. Due to the complex nature of pass-through entities, they often represent a challenge for tax administration.

The pass-through audit program is a combination of office and field audits at both the business and individual level. In the chart below, individual and business tax collections are represented.

Pass-through entity tax audit collections for fiscal year 2014 totaled \$2.3 million. (Partnership and S-Corporation collections totaled \$1.9 million plus the \$400,000 represented by the shareholders individual audit collections)

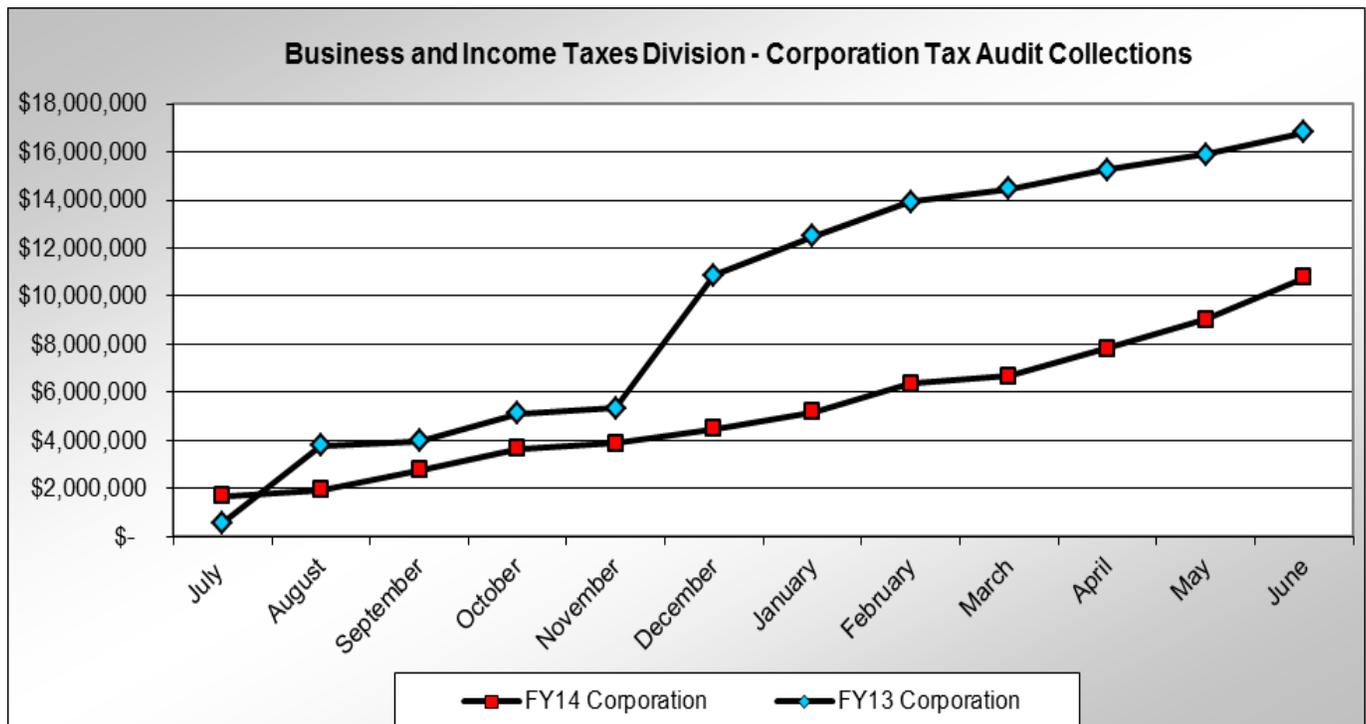


Note: Individual audit collections are counted in both the individual income tax audit collection chart and the pass-through entity tax audit collection chart.

Corporate Income Tax

Montana’s corporate income tax is a franchise tax levied on corporations for “the privilege of carrying on business in this state.” The tax is levied at the rate of 6.75% on net income earned in Montana. Corporations conducting business that is taxable both within and outside the state (multi-state corporations) are required to allocate income to Montana based on an equally-weighted, three-factor apportionment formula, where sales, property, and payroll are the three factors.

Corporation tax audit collections for fiscal year 2014 totaled \$10.8 million.



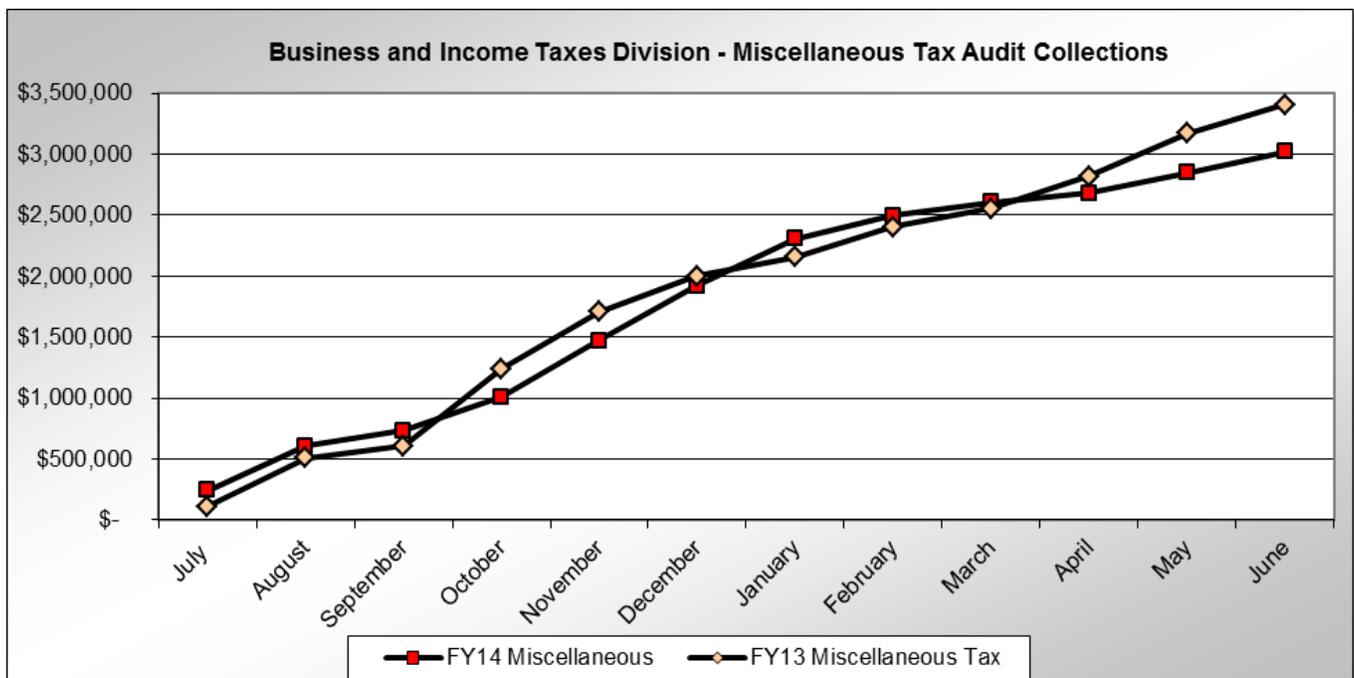
Miscellaneous Taxes

Various miscellaneous taxes are imposed in Montana including excise taxes, wholesale taxes on distributors, cigarette taxes from internet sales, and special assessments. The BITD tracks collections on over 15 different miscellaneous taxes.

Several miscellaneous taxes that make up a significant part of the division's audit collections are:

- Retail Telecommunications Excise Tax
- Electrical Energy Tax
- Wholesale Energy Transaction Tax
- Public Service Commission Tax
- Consumer Counsel Tax
- TDD Telecommunications Service Fee
- Statewide 911 Emergency Telephone System Fee
- Lodging Facilities Use Tax
- Rental Vehicle Tax
- Cigarette/Tobacco Products Tax
- Nursing Facilities Bed Tax
- Abandoned Property
- Contractor's Gross Receipts

Miscellaneous tax audit collections for fiscal year 2014 totaled \$3.0 million.



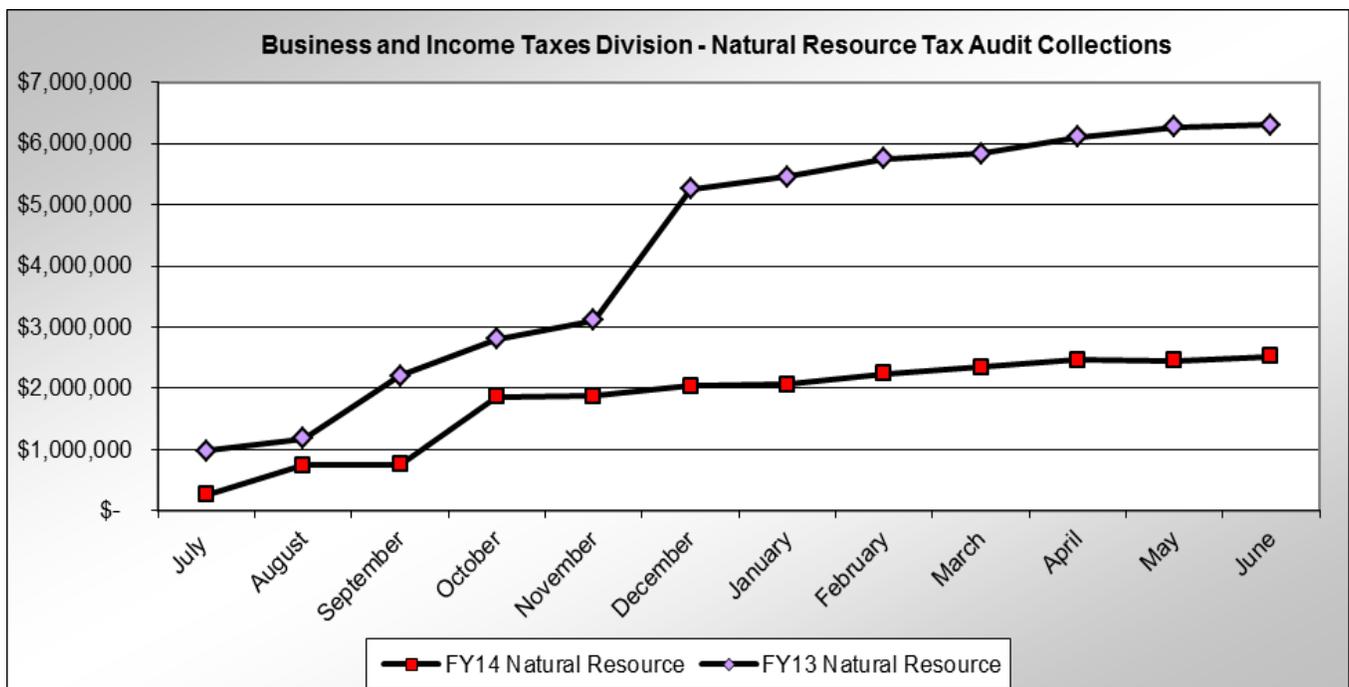
Natural Resource Taxes

Generally, natural resource taxes may be categorized as either severance/license taxes, or some form of ad valorem taxes. Each of the different natural resource taxes in Montana vary by certain characteristics including tax rates, filing requirements, disposition of the tax, and production tax incentives.

Natural resource tax collection is largely made up of the oil and natural gas production tax, however other sources of significant revenue are:

- Coal severance tax
- Coal gross proceeds tax
- Metalliferous mines license tax
- Metal mines gross proceeds tax
- Bentonite production tax
- Miscellaneous mines net proceeds tax
- Resource indemnity and groundwater assessment tax
- Cement and gypsum tax
- Federal mineral royalties

Natural resource tax audit collections for fiscal year 2014 totaled \$2.5 million.

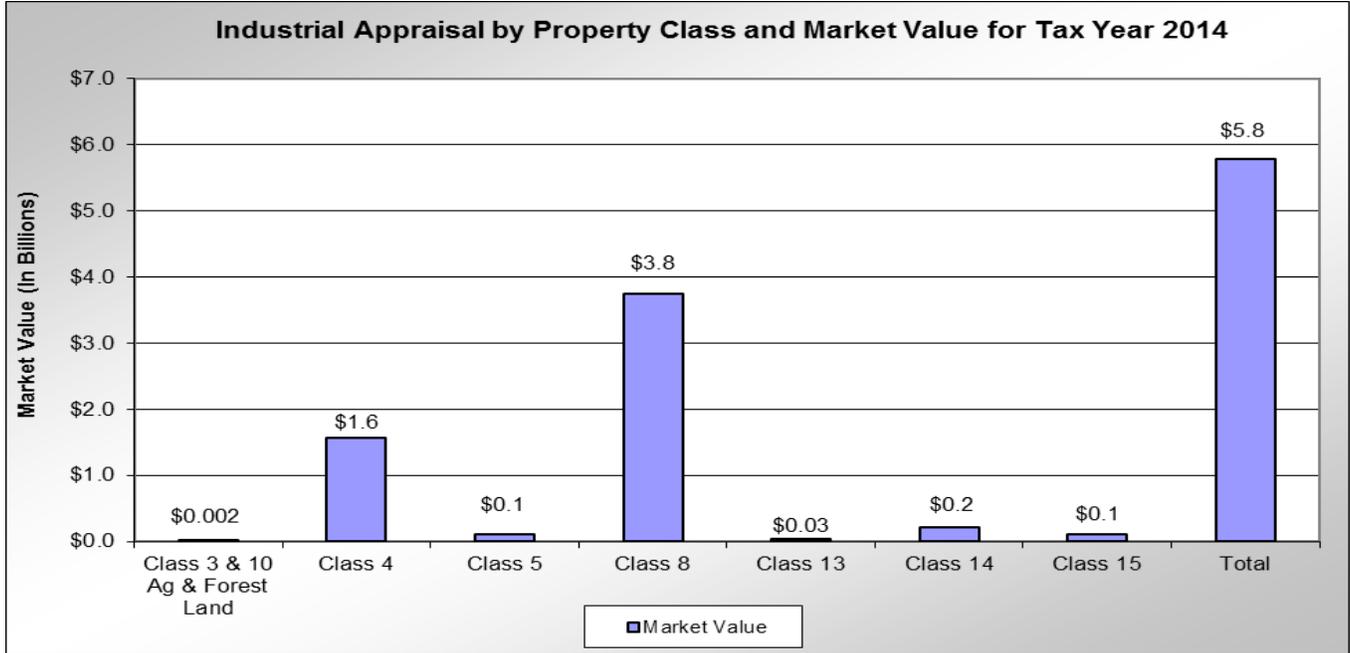


Industrial and Centrally Assessed Property

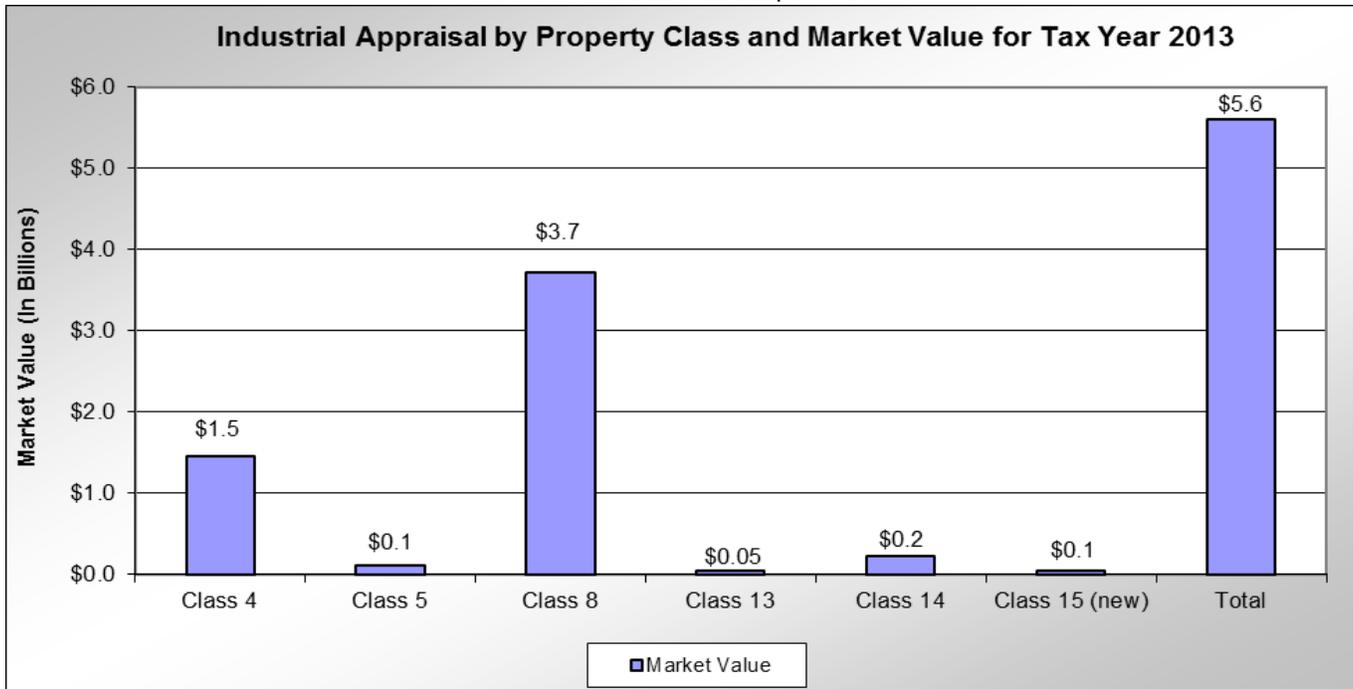
Industrial Property Appraisals:

- Responsible for the appraisal and assessment of approximately 1,900 parcels of taxable property located across the State of Montana;
- Includes large companies within the grain industry, mining, wood products, and oil refining, plus many smaller commercial manufacturing companies and companies that have established locations in more than one county in the state.

2014 Market Value: \$5.8 billion



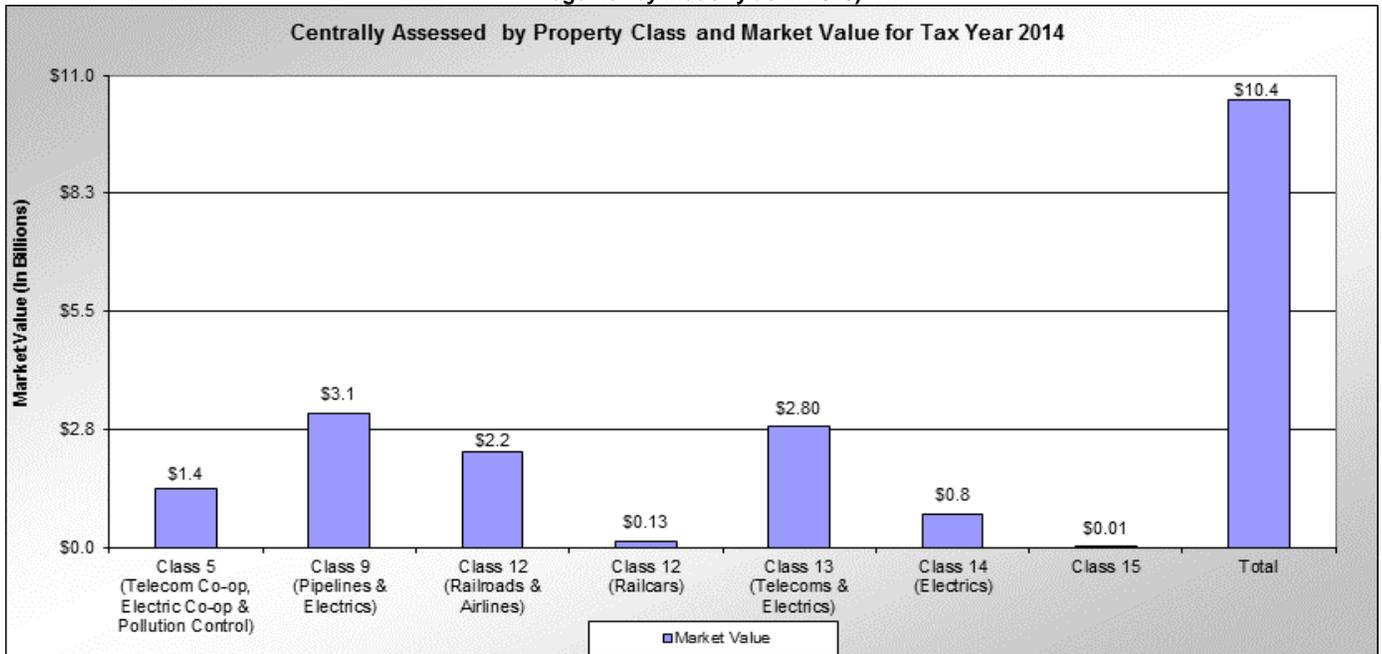
2013 Market Value: \$5.6 billion



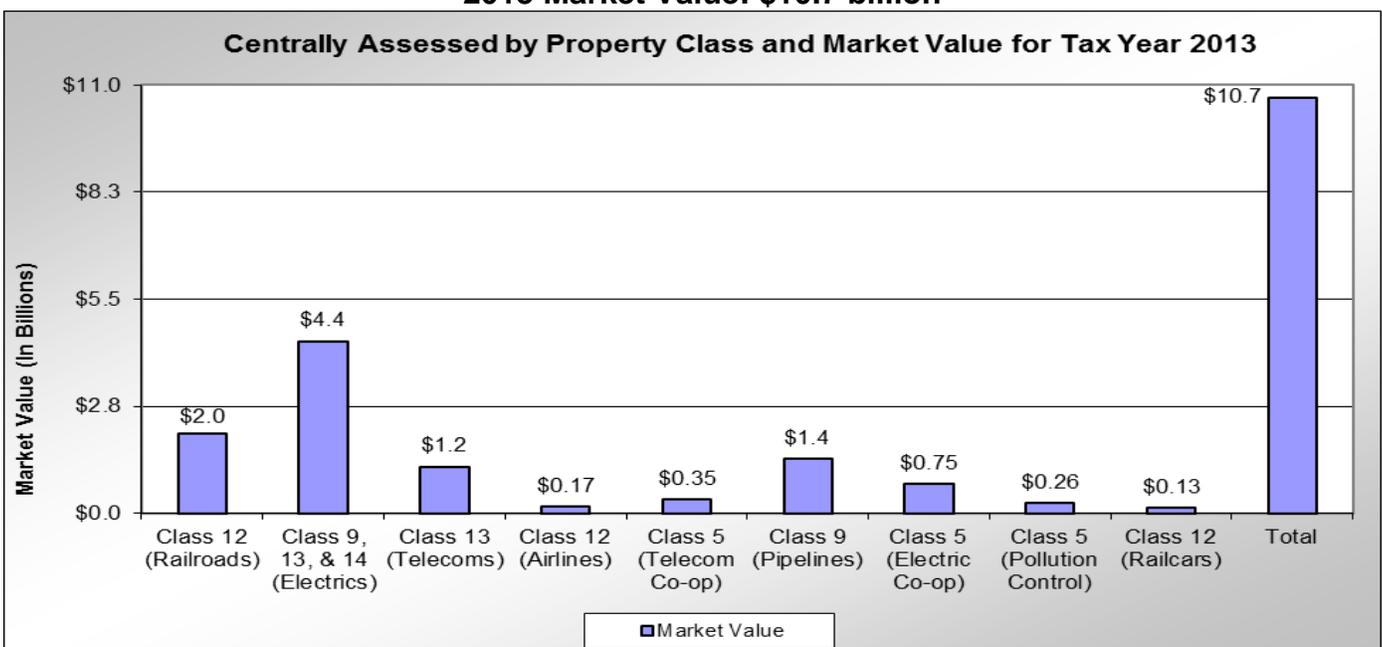
Utility Property Appraisals:

- Responsible for the appraisal and assessment of approximately 330 public utility type properties located across the state or the country.
- State of Montana has the responsibility to assess for ad valorem tax purposes certain properties or portions of properties of large corporations that operate across county and state lines.
- Includes properties of railroads, utilities, pipelines, airlines, water transportation companies, railroad car companies, electric cooperatives, communications companies, and other public service companies.

2014 Market Value: \$10.4 billion (reporting of appraisals by class has changed as companies are not grouped together by industry as in 2013)



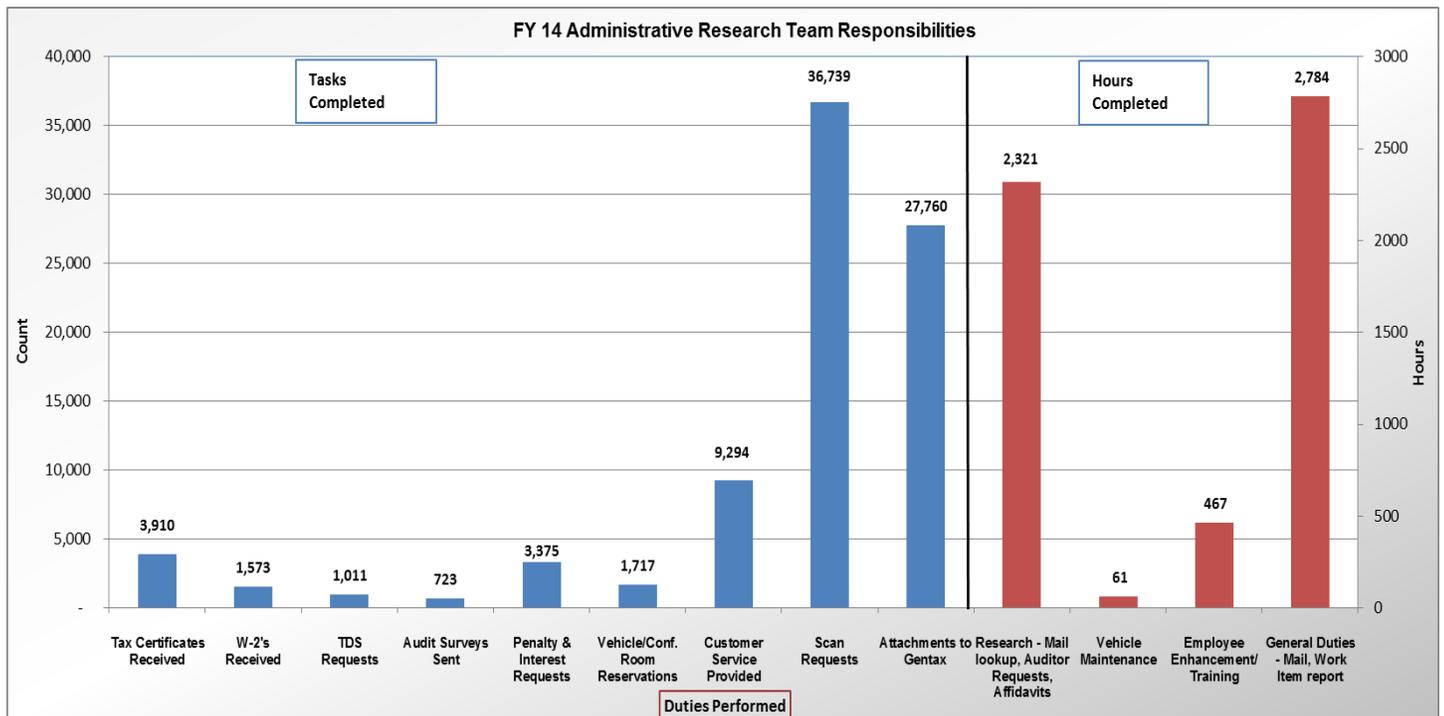
2013 Market Value: \$10.7 billion



Administrative Research Team

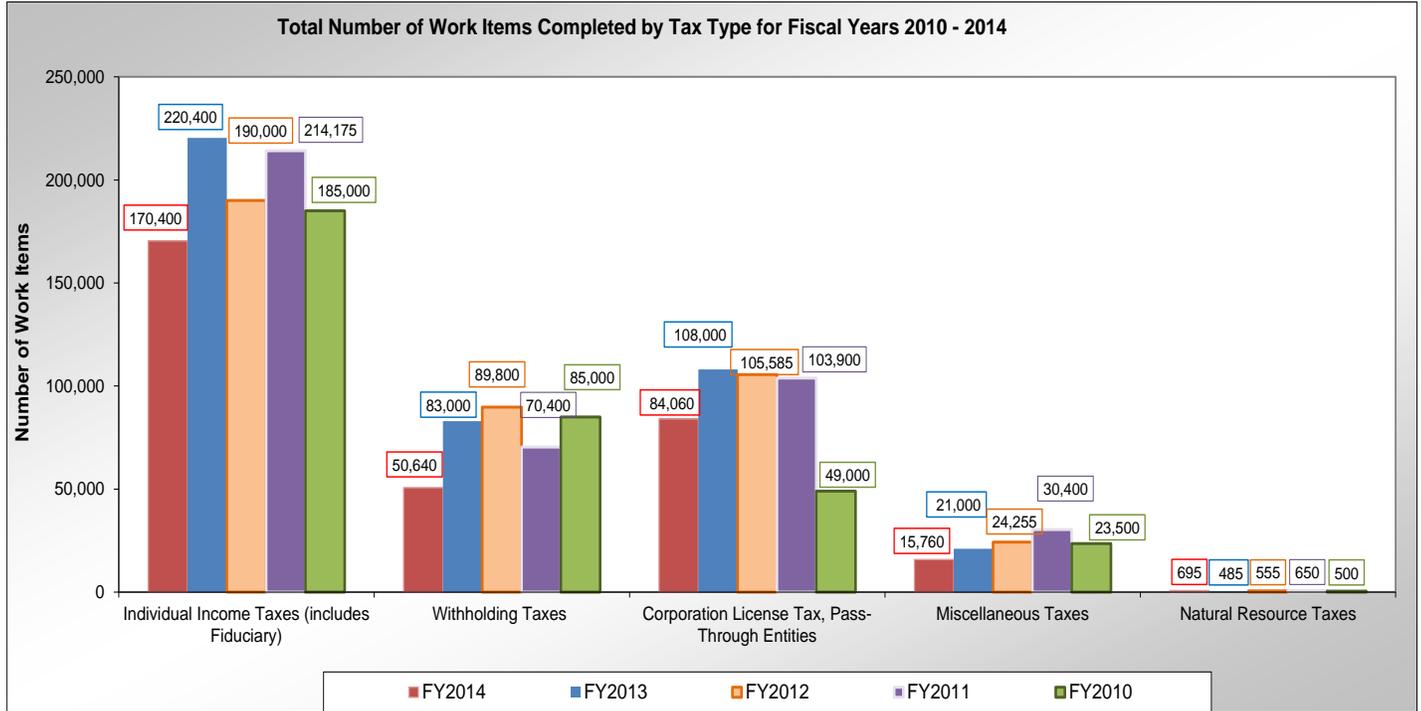
The administrative team is responsible for a wide variety of duties that span across the two bureaus. Several of these duties include:

- Tracking/documentation of the Statement of Account (SOA) objections, suggested replies, correspondence and legal referrals
- Front desk responsibilities – greeting/assisting taxpayers
- Management of state vehicles – tracking mileage, assign/manage the appointments to reserve the vehicles
- Scan and attach information from taxpayer to Gentax
- Web page maintenance: newsletters, division updates
- Transcript Delivery System (TDS) Requests – pulling data from Federal data base, logging and providing info. to auditors
- Complete requested tax certificates for all business types
- Assist taxpayers with requests for W-2s from previous years
- Assist the processing division during income tax season researching refunds that were returned due to bad addresses
- General administrative activities.



Work Items-Completed in FY14 Compared to FY10 - FY13

A work item is a task that is tracked by Gentax and must be completed. Work items can be assigned to specific users, or put in a work item queue by the system. Users may search and work them accordingly. Work items can be manually created or automatically generated through Gentax for the majority of all tax types in the system.

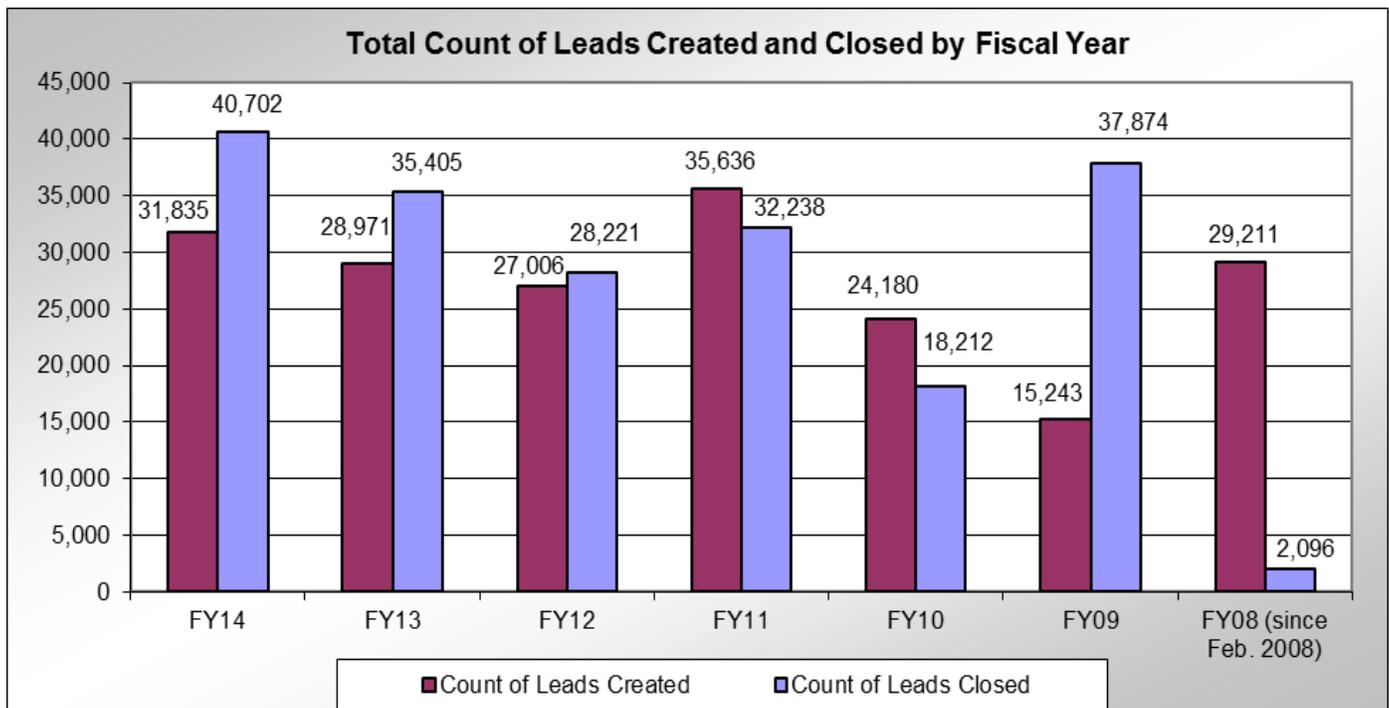


GenTax Discovery

Discovery is a Gentax product that is able to retrieve and cross match pertinent data for the purpose of “discovering” opportunities to improve tax compliance from non-registrants, non-filers, and under-reporters. Discovery uses data imported from external sources such as data files received from the Internal Revenue Service, other state agencies, and internal Gentax data that is all stored in a data warehouse in Gentax.

Since the development and implementation of Gentax Discovery, managing and working potential audit leads has become an integral part of the BITD’s daily operations. Through the use of Discovery, the division can better identify, analyze, and investigate multiple data files to effectively pursue more accurate assessments of tax liabilities. In conjunction with Discovery, the data warehouse has also proven to be a fundamental tool in effectively leveraging large volumes of data in one single location.

Building and working discoveries has become the primary method of identifying non-filers and upholding compliance initiatives for the main tax types that include individual income tax, wage withholding, pass-through entities, and corporation income tax. Leads that are created for auditors to work or review may generate either an office or a field audit.



Statement of Account (SOA) and Tax Appeals

The Statement of Account (SOA) is sent to a taxpayer detailing the net liability, interest, penalties, payments that have been made, and the amount due.

An SOA is generated monthly and sent to taxpayers who have a debt on account types administered by the department or by another government agency contract. If the taxpayer disagrees with the SOA balance, they may submit an objection within 30 days of when the SOA was sent. An SOA objection indicator is created on the account and removed when the balance is resolved, a payment plan is created, or the account moves to the next level in the appeal process.

Since most SOA's are generated primarily through the main tax types listed below, only the SOA objections received for the following tax types are reported on.

FY 2014 – Individual Income Tax

Out of the total SOA's mailed, only 0.5% had an SOA objection indicator created.
--

Within the fiscal year, 93% of all SOA objection indicators created are ceased.

FY 2014 – Corporation License Tax

Out of the total SOA's mailed, only 2% had an SOA objection indicator created.
--

Within the fiscal year, 87% of all SOA objection indicators created are ceased.

FY 2014 - Pass Through Entity

Out of the total SOA's mailed, only 2% had an SOA objection indicator created.
--

Within the fiscal year, 89% of all SOA objection indicators created are ceased.

FY 2014 - Lodging Facility Sales and Use Tax

Out of the total SOA's mailed, only 0.3% had an SOA objection indicator created.
--

Within the fiscal year, 88% of all SOA objection indicators created are ceased.

Fraud Prevention

Fraudulent activity including ID theft is one of the fastest growing crimes in America. Every year more emphasis is put on mitigating fraud and decreasing the revenue lost to fraud. There are specific Gentax fraud tools to assist the BITD in detecting fraud up front before the returns are processed and refunds are issued.

The Gentax Data Exchange (DEX) manager is an electronic, automatic, and secure exchange of data with other states. Currently there are 12 participating states including Montana (AL, AR, GA, ID, LA, MN, ND, NM, UT, WI, WV).

Before a return is processed, built-in rules or edits are automatically verified up front and any identified errors will suspend the return and require an auditor to correct it. Once the return is cleared, a second level of verification takes place before a refund is issued.

The Gentax Refunds manager is used to identify potential fraudulent refunds before they are sent out to taxpayers. Refunds may be flagged for suspicious activity pertaining to potential fraudulent information.

The Suspicious Filer Exchange Program is sponsored by the FTA (Federation of Tax Administrators) and assists states in identifying and stopping fraudulent state refunds. Currently there are 41 participating states including Montana.

Verified Fraud in Montana	Number of Fraud Accounts	Dollar Amount Prevented from being Refunded
TY 2009	64	\$77,000
TY 2010	185	\$100,000
TY 2011	142	\$227,000
TY 2012	972	\$776,000
TY 2013 (through September 13, 2014)	1,106	\$1,259,400